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Ways of covering

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cerns transacting an honest, serviceable business, because of the cloud spread over them by dishonest, irresponsible brokers. Now to have corruption unearthed in a firm of hitherto unchallenged integrity seems like imposing a burden unnecessarily heavy. And the latest of these exposés will perhaps be more far-reaching in its damaging effects than all the bucket-shop prosecutions and convictions. "When," one may ask, "is the public safe in dealing with a brokerage concern, if even reputable stock exchange houses go to the wall through internal defections?" In particular this may apply to trustees whose trust investments are in the form of securities.

It is a matter of common knowledge that many stock exchange houses have their accounts audited periodically by qualified public accountants. In the course of such audits cash and securities in hand are inspected and balanced out, funds on deposit are proved by certification and reconciliation, customers' balances and securities are submitted to confirmation by the customers,

collateral out against borrowings is verified, and securities in course of transfer or registration are substantiated. Perhaps it is too much to say that such firms have never sustained losses through irregularities of dishonest employees. On the other hand, hundreds of cases have been discovered by accountants in time to prevent the shortage from attaining substantial size. There are specific instances where secret trading and speculation of partners in violation of co-partnership agreements have been uncovered before they got beyond control.

The proposed plan of the New York Stock Exchange to require that members shall have their accounts audited periodically by independent accountants is a hopeful sign for the future. Such scheme, undoubtedly, will have many beneficial results; reducing if not preventing entirely embezzlement by employees or others, discovering irregular and *ultra vires* acts of firm members, safeguarding the interests of customers and creditors, and restoring public confidence.

Ways of Covering

PARAPHRASING the well-known quotation of "nothing succeeds like success," it may be said, "Nothing illustrates the application of a principle like a concrete case." The work of detecting financial irregularities is complicated, exacting, and must be carried on, often under troublesome conditions and mental strain, with speed and sureness. Admittedly it is trying work. But any amount of abstract generalization will not convey adequately, like actual cases, an idea of the difficulties involved in this kind of work. One fundamental fact must always be kept in mind, namely, if there has been a defalcation, there is strong likelihood that an attempt has been made to cover it. The ways of covering are legion. As a matter of interest as well as for the educa-

tional value which attaches thereto, several cases from actual experience, illustrating ways of covering, are reproduced below.

The cashier and bookkeeper of a wholesale jewelry house perpetrated a shortage of about \$8,000, through the interception of collections from customers, crediting certain customers' accounts without entering the corresponding amounts in the cash book, and substituting certain checks in place of currency when making deposits in the bank.

In a clumsy attempt to bring the details of the customers' debit balances into agreement with the control certain accounts were charged with fictitious amounts or existing charges were increased without any corresponding credits.

The custodian also attempted to conceal these manipulations during the audit by watching the progress of the footing of the cash book and inserting items credited to customers' accounts but not deposited, in blank spaces on pages where the footings already had been checked. In some instances, where checks deposited to cover shortages exceeded the amount of cash abstracted, fictitious credits to customers' accounts to adjust these differences were made in the cash book.

In a few instances, cash was abstracted without any effort being made until later to cover the resulting shortage. Shortages in certain of the bank accounts were covered by depositing therein checks received from customers without entry in the cash book. Entries in the bank pass books were altered to agree with the cash book after the pass books had been balanced and returned by the banks and false copies of deposit slips which showed amounts in agreement with the receipts as entered in the cash book were made for office files.

In the case of a foreign sales agency of an American concern, it was found that during a period of ten months the manager had misappropriated about \$1,000 by charging to a "Duties account" amounts in excess of invoices rendered by the company's customs broker. The original invoices, for the correct amount of duty, were destroyed by the manager and fraudulent invoices for increased amounts were prepared by him on genuine bill heads of the customs broker which he was able to obtain. Checks ranging in amounts from \$321.75 to \$1,354.04 were drawn to the order of the customs broker for the amounts of the fraudulent invoices, and after forged endorsements had been executed were cashed by the manager, who then paid the customs broker in currency the amount called for by the original invoices, retaining the difference.

An investigation of the accounts of an oil company, for the purpose of determining whether or not a shortage existed, revealed the fact that the bookkeeper and cashier was short about \$5,000, and that the defalcation extended over a period of two years. The bookkeeper changed the names of payees on checks and either cashed the checks or deposited them in his own bank account. The alteration was made possible by the use of checks printed on unprotected paper. The checks required the signatures of two officers of the company. The bookkeeper prepared the checks, had them signed, and, using ink eradicator, changed the name of the payee to his own name. At the end of the month, when paid checks were returned by the bank on which drawn, the bookkeeper, again using ink eradicator, changed the name of the payee from his own name to that of the original payee, eradicating his own endorsement and forging the endorsement of the original payee. In other instances it was found that the names of payees had been changed but that endorsements had been forged.

The first embezzlement of a bookkeeper who had control of company funds apparently was the result of accident. A check was drawn for \$300 and certified for a payment that required either currency or a certified check. Before delivery of the check, the amount of the item was determined to be \$304.17. The bookkeeper was told to enter as a disbursement the \$300 check which had not yet been entered, to draw a new check in the amount of \$304.17, have it certified, and deposit the first check. Both checks were entered on the credit side of the cash book and charged to vouchers payable. Before the check to be deposited had been entered on the receipt side of the cash book, it occurred to the bookkeeper that he had more than \$300 in currency which he was to deposit. Instead of en-

tering the check for \$300 as a receipt, he took \$300 in currency from the deposit, substituting the certified check in place thereof. At the end of the month he overfooted the total column in the voucher record in the amount of \$300 and distributed the amount equally over expense columns.

Early in the following year the bookkeeper, evidently encouraged by his success in the first instance, carried on a campaign of padded vouchers, duplicate invoices, and duplicate payments, through which he covered abstractions of about \$2,000.

A shipping company and three coal companies, with their principal offices in New York City, maintained a joint office and supplies of coal at one of the southern seaports. In addition to coastwise and foreign shipping and supplying coal to such carriers, the coal companies supplied coal to various and sundry ships calling at that port. The manager of the joint office was also vice-president of one of the local banks. He misappropriated over \$100,000 of funds belonging to the parties to the joint arrangement.

The funds were fraudulently obtained, by abstraction, by interception of receipts, and by improper withdrawal of funds on deposit. The larger part of the amount was obtained through interceptions and improper withdrawal, due no doubt to the fact that the specific funds with which the manager was charged were small in amount.

As to interceptions, the amounts so obtained came from unrecorded sales of coal, the proceeds being deposited in a personal bank account of the manager. In addition, various sums intercepted came from drafts issued by the masters of foreign vessels on their owners, which drafts were made in sterling and were sold by the manager to the local bank which issued in payment thereof cashier's checks to the order of the

company which furnished the coal. These cashier's checks were then deposited by the manager in a personal bank account, the credit being made possible by an arrangement through which the manager carried an account at the bank in the joint name of himself and the corporation.

Misappropriations arising through improper withdrawals were effected by drawing checks of one company to the order of another company, marking the transactions as loans but depositing the checks in the joint account of the manager.

The shortage was concealed in part by using checks constituting disbursements of one company as receipts of one of the other companies, commonly known as "kiting," but to a large extent by overstatement of bank balances in letters of certification issued by the bank of which the manager was vice-president. The amounts overstated sometimes ran as high as \$45,000. In other words, when the balance in the bank was actually \$38,000 the letter of certification showed the amount as \$83,000. This deception was made possible by reason of the fact that the vice-president had the letters of certification prepared by his own stenographer, after which he signed them personally.

The paying teller of a bank in a large city was short \$9,000. A bank examination was in progress and the particular examiner who was to count this teller's cash entered the cage and was standing in the rear, waiting for the teller to complete his proof. The teller, realizing an exposure was imminent, made out a spurious check for the amount of his shortage drawn on another bank in the same city, signed by a fictitious woman's name. This check was duly included in exchanges for the clearing house, the teller's balance was found correct, and the shortage remained undetected at that point. The next day the defaulting teller telephoned the bank on which the spurious

check was drawn, saying that a woman depositor had just telephoned, informing him that she had the day before deposited a check drawn on the wrong bank. The defaulting teller advised the teller of the bank on which the check was drawn that he would send a messenger with funds to take up the check in question when it reached the drawee bank from the clearing house. He accordingly dispatched a bank messenger with the necessary funds taken

out of his own till, which by that time had been released from control by the examiners, received the spurious check and destroyed it. No evidence of the shortage, therefore, came to the examiners by way of returned checks and the shortage still remained undisclosed. It was discovered later during the course of the examination, when suspicion, aroused by certain peculiar entries in his records, was directed to the teller.

Book Review

Bell, William H., and Powelson, John A. *Auditing*. (New York, Prentice-Hall, Inc., 1924. 518 p.)

In judging any technical treatise there are three main points which should receive consideration: Does it add to the existing literature on the subject or present existing material in a more satisfactory manner? Is it authoritative and reliable? Is the material adaptable to practical use?

Answering these questions in relation to the book under review there is no possibility of departing from the affirmative. There is nothing extant just like it as far as the reviewer is aware.

Considering the contents somewhat in reverse order, the cases, questions and suggested lesson assignments are a novelty in auditing text-books and constitute a factor which should go far in making the book useful for teaching purposes, which is one of the avowed desires of the authors. Admittedly, nothing can take the place of practical experience as a means of learning how to apply auditing principles, but cases offer as good a substitute as may be found. Of these the authors have provided nineteen covering many of the points which arise in auditing practice. The cases are supplemented with one hundred and seventy-three questions, including thirty taken from the New York C. P. A. questions on auditing set at the June, 1923, and

January, 1924, examinations. Solutions to the cases and answers to the questions are to be published separately.

Lest the foregoing emphasis on cases obscure that part of the book in which is discussed the principles and practice of auditing, it may be said that while generally speaking there is nothing strikingly new as to content, a certain strain of practicality runs through the whole text, giving it a touch not previously attained by authors on the subject. This undoubtedly may be ascribed to the author's up-bringing and professional experience in which he has been under the necessity of considering the practical as well as the theoretical side of auditing practice. To the same reason may be traced the professional slant which attaches to much of the exposition.

The discussion may be characterized as authoritative and reliable. Born of practical experience, the author's views are sound and his arguments generally convincing; further, they are orthodox to a marked degree. The tendency to didacticism, which is strong, and properly so for the student audience, might have been relieved for practitioners by the introduction of more illustrative experiences. But, then, auditing is a serious matter.

The book is subject to criticism for the brevity with which "working papers" and "reports" have been dismissed. True, the